



OFFICE OF
INSURANCE COMMISSIONER

In the Matter of

No. G 03-79

The Financial Examination of **SAFECO LIFE INSURANCE COMPANY** A Domestic Insurer.

FINDINGS, CONCLUSIONS, AND ORDER ADOPTING REPORT OF FINANCIAL EXAMINATION

BACKGROUND

An examination of the financial condition of **SAFECO LIFE INSURANCE COMPANY** (the Company) as of December 31, 2000, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of authority as a stock insurer. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and comments and recommendations was transmitted to the Company for its comments on June 11, 2003. The Company's response to the report is attached to this order only for the purpose of providing convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners' work papers, and submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 2 through 42 of the report.

CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **SAFECO LIFE INSURANCE COMPANY** and to order the Company to take the actions described in the Instructions and Comments

and Recommendations sections of the report. The Commissioner acknowledges that the Company may have implemented the Instructions and Recommendations prior to the date of this order. The Instructions and Recommendations in the report are an appropriate response to the matters found in the examination.

ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Company is ordered as follows, these being the Instructions and Comments and Recommendations contained in the examination report on pages 2 through 18.

1. The Company is ordered to comply with RCW 48.05.250(1) which requires the Company to file a true statement of its financial condition, transactions and affairs. This order is specifically relevant to each of the following:

Instruction 1 – Inadequate Accounts and Records – Examination Report, page 2.

Instruction 6- Common Stock – Investment in Affiliates Improperly Valued – Examination Report, page 10.

Instruction 8 – Guaranty Funds on Deposit Not allowed as Future Offset to Taxes – Examination Report, page 10.

Instruction 9 – Accrued Interest on Derivative Instruments Not Supported by Company – Examination Report, page 10.

Instruction 11 – Error In Liability for Amounts Held for Agents' Account – Examination Report, page 11.

Instruction 12 – Unreconciled Balance in Account Included in Aggregate Write-Ins for Liabilities – Examination Report, page 11.

Instruction 15 – Bonds – Maturity Date and Interest Rate Errors – Examination Report, page 13.

Instruction 16 – Errors in Annual Statements – Examination Report, page 13.

2. The Company is ordered to ensure that all accounting controls be reviewed, and deficiencies identified and corrected in compliance with RCW 48.05.280. This order is specifically relevant to each of the following:

Instruction 1 – Inadequate Accounts and Records – Examination Report, page 2.

Instruction 9 – Accrued Interest on Derivative Instruments Not Supported by Company – Examination Report, page 10.

Instruction 14 – Custodial Responsibilities – Examination Report, page 12.

Instruction 15 – Bonds – Maturity Date and Interest Rate Errors – Examination Report, page 13.

Instruction 17 – Incomplete and Incorrect Finance Committee Minutes – Examination Report, page 17.

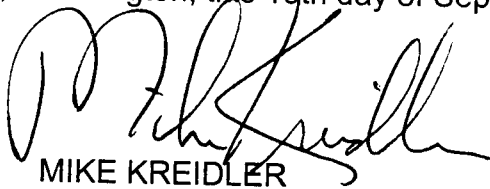
3. The Company is ordered to ensure compliance with all pertinent sections of chapter RCW 48.31B. In addition, the Company is ordered, pursuant to RCW 48.31B.030(1)(b)(iv), to submit for approval to the Washington State Insurance Commissioner's Office an inter-company agreement with SAFECO Asset Management Company (SAM) and pertinent affiliates which complies with RCW 48.31B.030(1)(a). Instruction 2, Examination Report, page 6.
4. The Company is ordered to comply with the remedies contained in RCW 48.31B.050(3) in regards to the Barrier Ridge LLC transactions and divest itself of that investment as required by Special Consent Order No. 95. Instruction 3, Examination Report, page 7.
5. The Company is ordered to comply with RCW 48.13.290(1) and dispose of any ineligible foreign securities in a time frame as specified under Special Consent Order No. 94. Instruction 4, Examination Report, page 8.
6. The Company is ordered to put controls in place to ensure compliance with RCW 48.12.010 which provides that in the determination of the financial condition of any insurer there shall be allowed as an asset only such assets as belong wholly and exclusively to the insurer, and which are registered, recorded, or held under the insurer's name. Instruction 5, Examination Report, page 9.
7. The Company is ordered to comply with RCW 48.12.020(1) which does not recognize goodwill in the valuation of a subsidiary pursuant to RCW 48.12.180(3). Instruction 6, Examination Report, page 10.
8. The Company is ordered to comply with RCW 48.12.010 that provides in the determination of the financial condition of any insurer there shall be allowed as an asset only such assets as belong wholly and exclusively to the insurer, and which are registered, recorded, or held under the insurer's name. Instruction 7, Examination Report, page 10.

9. The Company is ordered to correctly record assets for guaranty funds receivable or on deposit. Instruction 8, Examination Report, page 10.
10. The Company is ordered to correctly report accrued interest on derivatives. Instruction 9, Examination Report, page 11.
11. The Company is ordered to report mutual fund accounts in the Company's name in compliance with RCW 48.12.010. Instruction 10, Examination Report, page 11.
12. The Company is ordered to correctly report liabilities for Amounts Held for Agents' Account. Instruction 11, Examination Report, page 11.
13. The Company is ordered to correctly report unreconciled balance offsets. Instruction 12, Examination Report, page 11.
14. The Company is ordered to correct and maintain amortization schedules on individual investments that will tie to the amortization reported in Schedule D and is instructed to comply with RCW 48.12.170(1)(b) which provides that bonds or evidences of debt having a fixed term and rate purchased above or below par shall be valued on the basis of the purchase price adjusted so as to bring the value to par at the earliest date callable at par or maturing at par or in lieu of such method, according to such accepted method of valuation as is approved by the commissioner. Instruction 13, Examination Report, page 12.
15. The Company is ordered to require its custodian(s) to produce accurate, reliable listings of all securities at amortized par value for purposes of accurate reconciliation and reporting. Instruction 14, Examination Report, page 13.
16. The Company is ordered to reconcile Company records with bank custodial records to accurately reflect amortized values in compliance with RCW 48.12.170. Instruction 15, Examination Report, page 13.
17. The Company is ordered to keep complete and correct finance committee minutes in compliance with RCW 48.13.340. Instruction 17, Examination Report, page 17.
18. The Company is ordered to adopt individual investment guidelines that cover the investment requirements in the Washington Insurance Code. Comments and Recommendations 1, Examination Report, page 17.

19. The Company is ordered to review custodial agreements to ensure the inclusion of a provision which provides for legal succession of rights and responsibilities under the original custodial agreement. Comments and Recommendations 2, Examination Report, page 18.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Tumwater, Washington, this 19th day of September, 2003.


MIKE KREIDLER
Insurance Commissioner



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INSURANCE COMMISSIONER
COMPANY SUPERVISION

COPIED

Mr. James T. Odiorne, CPA, JD
Deputy Insurance Commissioner
Company Supervision Division
Office of the Insurance Commissioner
P. O. Box 40255
Olympia, WA 98504-0255

Re: Examination Report of Safeco Life Insurance Company
as of December 31, 2000

Dear Mr. Odiorne:

Enclosed are Safeco's responses to the draft reports of examination. Do not hesitate to contact me if questions or concerns arise in the course of your review.

We would like to take this opportunity to express our appreciation for the professionalism demonstrated by the Department staff. We appreciate having had the opportunity to work with them.

Sincerely,

Laura M. Murphy
Counsel

Enc.

SAFECO LIFE INSURANCE COMPANY
("the Company")

COMPANY RESPONSES

Safeco Life Insurance Company has reviewed the Instructions, Comments and Recommendations contained in the Report of Examination (as of December 31, 2000), and makes the following responses. In general, corrections or changes in procedure required by the report already have been put into place. There are some matters about which the Company disagrees with the report's findings, and these are described below.

INSTRUCTIONS

1. Inadequate accounts and records

The Company believes that it has in place the controls needed to maintain compliance with contracts and that it does in fact comply with contracts. The Company has made the necessary corrections or changes in procedure. However, it takes exception to two findings:

Item (d): The Company believes the loans under the Chase Manhattan Bank Securities Lending Agreement (now: JP Morgan Chase) were properly collateralized. Loans are marked to market each morning. Brokers are notified of collateral calls based on that morning mark and additional collateral is collected or returned to the borrowing broker. If there has been substantial movement in the market price of the underlying security, loans may be out of compliance for the business day in which the preceding business day's collateral is matched to the security's current price. The Company's operations unit regularly monitors such collateral for compliance and notifies JP Morgan Chase of any non-compliant collateral amounts. According to the terms of the Securities Lending Agreement, if additional collateral is then required, Chase will notify ("demand") the borrower. The borrower will then deliver such additional collateral "before the close of business on the date of such demand or as otherwise agreed."

The bond in the example shown in the report, Intermedia Communications, was priced at 62.50 on December 28, 2000. Chase would have required corresponding collateral (102%) of 63.75. The next business day, January 2, 2001, this bond was trading at 73.833. Chase would have requested additional collateral to achieve a collateral amount of 75.31. The collateral amount of 63.75 divided by that trading price of 73.833 equals 86.343% which approximates the 86.23% collateral reported by the custodial bank. The loan was, therefore, properly collateralized.

Item (k): The Company appreciates that the report notes that, by the end of the examination, the Company had reduced all bank account reconciliation variances to an immaterial amount.

2. Insurer Holding Company Act violations

Barrier Ridge: As to Barrier Ridge, the Company notes that this transaction is the subject of a Special Consent issued by the Department with which the Company is in full compliance.

Principle Protected Equity Linked Trust: As to Principle Protected Equity Linked Trust, the Company disagrees with the report's findings, as more fully described in Section 5, below.

Item (d): Within the Safeco group of companies and pursuant to the operation of existing intercompany agreements, we view employees who perform investment activity as employees of the entity for which they are performing investment services. For this reason, we believe it unnecessary to have an investment services agreement between the companies. However, the Company will comply with the instruction that a specific written agreement for investments be implemented.

3. Bonds – Investment in Barrier Ridge LLC

This investment constitutes an admitted asset pursuant to the terms of Special Consent Order No. 95, issued by the Office of the Insurance Commissioner on December 20, 2002. The Company has complied fully with the terms of Special Consent Order No. 95.

4. Investments in foreign securities

These investments constitute admitted assets pursuant to the terms of Special Consent Order No. 94, issued by the Office of the Insurance Commissioner on December 20, 2002. The Company is complying with the requirements of that Special Consent Order.

5. Investment in Principal Protected Equity Linked Trust

The Company asks that the Department reconsider this finding and treat the entire \$10,198,485 as an admitted asset. The Company respectfully disagrees with the conclusion that these securities were improperly held by a broker custodian, and is confident both that appropriate controls were in place and that there was compliance with RCW 48.12.010. The report incorrectly identifies Morgan Stanley as the custodian of the securities. Morgan Stanley was not the custodian; Morgan Stanley was the Reinvestment Administrator and Depositor, according to the terms of the November 12, 1999, agreement between the Company and Morgan Stanley. Morgan Stanley deposited the securities with and placed them under the control of Chase

Bank of Texas, as Trustee. Chase Bank of Texas was the custodian of these investments; therefore the securities were properly safeguarded as required by RCW 48.13.460. The Company also disagrees that the investment was not registered in the Company's name. Although there was a clerical error on the copy located in the Company's office, the original was re-issued and properly shows the Company as the investor. The Company asks that the Department reconsider this finding and treat the entire \$10,198,485 as an admitted asset.

6. Common stock – Investment in affiliates improperly valued

The Company has made the necessary correction or change in procedure.

7. Short-term investment not confirmed

The Company agrees that Chase Bank did not confirm the asset during the examination despite repeated requests, and has informed the bank that this is not acceptable. Regarding the absence of a CUSIP number, the Company notes that AIP Commercial Paper does not have a CUSIP because it is not a publicly traded fund.

8. Guaranty funds on deposit not allowed as future offset to taxes

The Company has made the necessary correction or change in procedure.

9. Accrued interest on derivative instruments not supported by company

The Company has made the necessary correction or change in procedure.

10. Separate accounts statement – Mutual fund accounts not in Company's name

The Company asks that the Department reconsider this finding, and treat the entire \$31,106,280 as admitted assets. The Company concedes there was a clerical error in that the trading accounts were under the wrong name (Safeco Mutual Funds, rather than Safeco Life Insurance Company). However, the clerical, non-substantive nature of this error is demonstrated by the following facts: (1) all buy and sell orders were per the instructions of the Company's policyholder instructions, not Safeco Mutual Funds' instructions; (2) none of the Mutual Funds included these investments in their financial statements; and (3) the Company clearly listed these investments in its Separate Account financial reporting. There was never any dispute that these were the Company's assets, not the assets of the Mutual Funds and, in fact, the naming error was corrected in the course of the examination. In addition, there is no legal entity called "Safeco Mutual Funds," and therefore no such entity that could own these investments.

11. Amounts held for agents' account

The Company has made the necessary correction or change in procedure.

12. Aggregate write-ins for liabilities

The Company has made the necessary correction or change in procedure.

13. Bonds - Amortization

The Company believes its amortization schedules are valid. The schedules were derived from an accounting model in PAM, an accounting system used by major insurers around the country.

14. Custodial responsibilities

The Company believes that its bank reconciliation records constitute "full and adequate accounts and records," and that they comply with RCW 48.05.280. During prior financial examinations, the Company worked with Department examiners to audit the electronic reconciliation process for accuracy and adequacy of controls. The Company's external auditors also have reviewed the process. In reliance on those reviews, the Company discontinued the practice of maintaining paper copies of custodian banks' statements. The Company instead retains copies of electronic bank reconciliations, and these were available, and continue to be available, for review by the examiners. These electronic statements constitute complete records under 48.04.280. The Company knows of no requirement that these records be preserved in a printable format.

15. Bonds – Maturity date and interest rate errors

The Company has made the necessary correction or change in procedure.

16. Errors in annual statements

The Company has made the necessary correction or change in procedure. However, it takes exception to two findings:

Item (c), MCI Capital: The Company respectfully disagrees about the proper reporting of these investments. MCI Capital was properly reported as preferred stock, and is not an industrial bond. According to Bloomberg, MCI Capital is a Quarterly Income Preferred Security, a Trust Preferred Security consisting of a preferred stock issued by a special trust and debt securities issued by the company. IES Utilities was properly classified as a preferred industrial and miscellaneous stock. According to Bloomberg, it is a Quarterly Income Debt Security, a security that emulates a Trust Preferred Security but without the trust.

Item (f), Great American Bank: The Company respectfully disagrees, and notes that the \$-714 amount was correctly entered as an adjustment during 2000 to correct the statement value reported during 1999. In order for the reported statement value to tie to the GAAP general ledger, this adjustment was needed during the 2000 reporting period.

17. Incomplete and incorrect finance committee minutes

The Company has made the necessary correction or change in procedure.

COMMENTS AND RECOMMENDATIONS

1. Investment guidelines

The Company is considering the recommendation that it maintain both individual company investment guidelines as well as individual state investment guidelines. The Company notes that it monitors investments for compliance with the Washington Code, and that this is a specific responsibility of the Corporate Finance compliance analyst. Corporate Finance has developed a comprehensive surveillance system to ensure that all Washington insurance company investments comply with the Washington investment code.

2. Custodial agreements

The Company is considering the recommendation that custodial agreements provide for legal succession of rights and responsibilities.

Respectfully submitted,



Christine B. Mead
Senior Vice President and Secretary